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District Inspector General for Audit

July 9, 1996

**Audit Related Memorandum**  
**No. 96-PH-185-1819**

MEMORANDUM FOR: Joseph K. Av ersano, Director, Community Planning  
and Development Division, Virginia State  
Office, 3FD

FROM: Edward F. Momorella, District Inspector General  
for Audit, Mid-Atlantic, 3AGA

SUBJECT: Citizen's Complaint  
Richmond Redevelopment and Housing Authority  
Accounting Controls Rehabilitation Loan Program  
Richmond, Virginia

Pursuant to a confidential citizen's complaint, we have completed a review of the Richmond Redevelopment and Housing Authority (RRHA) accounting for the rehabilitation loan program. The loan program uses a combination of Community Development Block Grant (CDBG ) funds and bank funds.

The complainant made several allegations of improper activity i n the RRHA's administration of H UD-funded programs. The allegations dealt with the application of the rehabilitation loan programs' s income and expenses, and the program's internal controls. Th e third allegation was referred to another Federal agency fo r appropriate action.

The scope of our audit work included: (1) determining if the RRHA was utilizing CDBG funds to reduce amounts due to the bank fo r rehabilitation loans made to homeowners; and (2) evaluating th e RRHA's internal accounting controls over the rehabilitation loa n program.

Based on the work performed, two findings were developed covering the following issues.

RRHA authorized its contracted loan servicing company to charg e \$36,388 in bank loan servicing fees to the CDBG program from June 30, 1993 through January 31, 1996. RRHA did not adhere to loa n servicing contracts, nor did RRHA properly match revenues wit h related expenses per OMB Circular A-87. RRHA officials believe

this is an eligible expense since the CDBG program requires a combination of CDBG and bank funds to implement the loan rehabilitation program. RRHA in effect, violated loan servicing agreements, improperly matched revenues and expenses, and reduced the amount of CDBG funds available for eligible CDBG activities.

RRHA needs to improve and strengthen internal accounting controls over the CDBG rehabilitation loan program. RRHA: does not utilize or verify the accuracy of remittance reports, and does not receive the same remittance report as the bank; does not properly reconcile bank statements to the general ledger, providing no assurance as to the accuracy of general ledger balances; does not maintain a complete data base to document the portfolio of rehabilitation on bank and CDBG loans; could not provide journal entries requested during our review; and accounting journals disclosed undetected incorrect accounting entries.

We recommend the RRHA: (1) discontinue charging the CDBG program bank loan servicing fees and repay the CDBG program for bank loan servicing fees paid with CDBG funds, and (2) obtain the same remittance reports submitted to the bank with the funds deposited, review them for accuracy, complete its loan portfolio database, and establish a system to secure and review journal entries.

The draft findings were discussed with the RRHA who provided a written response. The response was considered in the findings and included as Attachment 2.

Within 60 days, please give us, for the recommendations made in the memorandum, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued as a result of the review.

If you have any questions, please contact Irving I. Guss, Assistant District Inspector General for Audit, at (215) 656-3401.

#### Attachments

1. Findings and Recommendations
2. Auditee Comments
3. Distribution

**Finding 1 Bank Loan Servicing Fees Charged to the CDBG Program**

The Richmond Redevelopment & Housing Authority authorized it s  
contracted loan servicing company to charge \$36,388 in bank loa n  
servicing fees to the CDBG program from June 30, 1993 throug h  
January 31, 1996. RRHA did not adhere to loan servicing con tracts,  
nor did RRHA properly match re venues with related expenses per OMB  
Circular A-87. RRHA officials believe this is an eligible expense  
since the CDBG program requires a combination of CDBG and ban k  
funds to implement the rehabilitation loan program. RRHA i n  
effect, violated loan servicing agreements, improperly matche d  
revenues and expenses, and reduced the amount of CDBG fund s  
available for eligible CDBG activities.

According to the loan servicing agreements, the loan servicin g  
company shall retain a fee for each installment payment collected  
(meaning the bank loan fees are to come from the bank loa n  
proceeds ). The service fees vary from \$5 to \$10 per installmen t  
collected depending on the agreement.

OMB Circular A-87, Section C, Paragraph 2a., states that a cost is  
allocable to a particular cost objective to the extent of benefits  
received by such objective.

In the rehabilitation loan pro gram, RRHA establishes bank and CDBG  
fund loan groups. RRHA contra cts with a loan servicing company to  
collect and properly allocate installment payments to each of the  
bank and CDBG loan groups. The loan servicing company is paid a  
fee for each installment payment collected. RRHA and the loa n  
servicing company are not in compliance with respective loa n  
servicing agreements, because the loan servicing company has been  
instructed, by RRHA, to deduct all service fees from CDBG fu nds and  
not each installment collected.

RRHA's non-compliance with OMB Circular A-87 is similar to thei r  
non-compliance with the loan s ervicing agreements. RRHA maintains  
two general ledgers. Ledger 56 is titled other local funds an d  
includes bank loan funds, and ledger 57 represents CDBG funds .  
RRHA records collections (reve nues) on the bank loans in ledger 56  
and the servicing fee (expense) is recorded in ledger 57. I n doing  
so, RRHA is improperly matchin g revenue with expenses, contrary to  
OMB Circular A-87. There is n o benefit received by cost objective  
ledger 57.

According to RRHA's Deputy Director of Finance (DDF), the CDB G  
program requires a combination of CDBG and bank funds. The CDB G  
program allows the use of CDBG funds to pay for salaries of RRH A

employees and other miscellaneous costs associated with obtaining bank funds and operating various other programs administered with CDBG funds, which would include paying bank loan service fee s. The splitting of bank and CDBG funds came as a suggestion from RRHA's

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independent auditors and was strictly for financial statement presentation purposes.

The loan servicing agreements were not amended to document the decision to charge bank service fees to the CDBG program because it was not thought to be necessary at the time. The loan process is continually changing and being refined according to the DDF and new agreements will eventually reflect this decision. The language will be adjusted in future loan agreements. An amendment to the agreement was not done at the time because RRHA was too busy.

The CDBG program did not require the RRHA to combine CDBG funds with bank funds as stated by the DDF. That decision was made by the grantee when they designed the program.

In a memorandum dated December 16, 1991, the former Director of Finance instructed RRHA employees to have the loan servicing company deduct bank loan fees from CDBG loan collections rather than the bank loan collections because net collections of CDBG loan payments could absorb the bank loan fees. To determine the amount of CDBG funds used to pay bank loan fees, both the RRHA and the loan servicing company were asked to provide the schedules that disclosed the amounts. The time period obtained was from June 30, 1993 through January 31, 1996.

By using CDBG funds to pay for bank loan servicing fees the RRHA incurred ineligible costs of \$36,388 and reduced the amount of CDBG funds available for eligible CDBG activities.

### **Auditee Comments**

RRHA stated they had discontinued charging the CDBG program for the bank loan service fees effective January 31, 1996 and the \$36,388 will be forwarded to the city as program income by June 29, 1996. In addition, the RRHA will complete a review by July 31, 1996 to ensure compliance in all areas.

### **Recommendations**

We recommend your staff verify the RRHA has implemented the following:

- 1A. Discontinue charging the CDBG program bank loan servicing fees and repay ledger 57, from ledger 56, \$36,388 in CDBG funds

used to pay bank loan servicing fees from June 30, 199 3  
through January 31, 1996, and any additional fees charged to  
date. The funds should also be returned to the City a s  
program income.

- 1B. Properly match all future revenues and expenses per OM B  
Circular A-87.

**Finding 2 Improved Internal Accounting Controls Necessary Over the CDBG Rehabilitation Loan Program**

The RRHA needs to improve and strengthen internal accounting controls over the CDBG rehabilitation loan program. RRHA:

- does not utilize or verify the accuracy of remittance reports, nor receives the same remittance report as the bank,
- does not properly reconcile bank statements to the general ledger, providing no assurance of the accuracy of general ledger balances,
- does not maintain a complete data base to document the portfolio of rehabilitation bank and CDBG loans,
- could not provide journal entries requested during our review, and
- accounting journals disclosed incorrect accounting entries.

RRHA officials are planning to have their independent auditor conduct a review to improve internal accounting controls.

According to 24 CFR 85.20 Standards for financial management systems paragraph (b):

*"The financial management systems of... grantees and subgrantees must meet the following standards:*

*(2) Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.*

*(3) Internal Control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes."*

### Remittance reports not utilized or verified

The RRHA does not receive the same remittance reports the loan servicing company sends to the bank; therefore, is unable to effectively utilize the remittance reports. Also the RRHA is not reviewing the remittance reports for accuracy.

Monthly homeowner loan payment collections are documented by remittance reports the RRHA receives from the loan servicing company. These remittance report totals are used to establish a monthly loan receivable balance, which is not representative of actual collections deposited in the bank account. A different remittance report is sent to the bank. These remittance reports are generated by deposits from collections made by the loan servicing company. The deposits, made twice each month, are representative of actual collections deposited in the bank account. The remittance report received by the bank, shows up as credit memos on each bank statement.

By utilizing the remittance report RRHA is receiving, the following journal entries are made each month: An advance account is debited and mortgage receivable homeowners and interest income accounts are credited. When the bank statement is received, a journal entry debiting debt service, (a cash account), and crediting advances is made to record the actual cash received. By utilizing the same remittance reports the bank is receiving, RRHA can set up the receivable and eliminate the journal entry made when the bank statement is received. Use of the advance account is not necessary and entries to the general ledger become more meaningful. The remittance report totals could be reconciled to the bank statement and the RRHA would know where the cash deposited into the bank accounts came from. The remittance reports could also be utilized to track and update a loan portfolio data base.

The RRHA does not review remittance reports for accuracy. No apparent review is conducted to verify additions to or deletions from loan portfolios. Also, no review is conducted to ensure the transition from bank loan to CDBG loan is timely and accurate. RRHA is placing significant reliance on the loan servicing company to accurately report and track bank and CDBG loans.

According to RRHA officials, timing differences between the remittance reports they receive and the bank statements does not allow the RRHA to utilize the remittance reports in an effective manner. The DDF stated the RRHA is relying on the loan servicing company to post and track loan payments correctly. He agreed this is an internal control issue which needs to be addressed.

By not receiving the same remittance report as the bank, the RRHA is making unnecessary journal entries and increasing the likelihood of errors. By placing reliance on the loan servicing company the RRHA is not ensuring amounts posted to the general ledger are correct or that loan balances are accurately tracked and reported.

#### **Bank reconciliation not performed**

The RRHA does not reconcile bank statements to the general ledger, and has no assurance as to the accuracy of the general ledger. The RRHA is adjusting the general ledger accounts to agree with bank statement entries. The RRHA takes the credit and debit memos posted to the bank statements and posts those amounts to the general ledger to arrive at the account balances. Credit memos represent payments made by homeowners on their loans and bank fees not charged to the account. Debit memos represent deductions for payments made on the notes payable. Based on the bank statement and a supporting letter from the bank, notes payable and interest expense are debited and debt service credited to document the reduction of the note. As a result, RRHA is not reconciling the bank statements, but adjusting the general ledger to agree with the bank statements.

The DDF agreed no reconciliation was being performed and stated RRHA would be agreeable to recommendations to correct this internal control weakness.

#### **Rehabilitation loan data base incomplete**

There is no available data base documenting the RRHA's portfolio of rehabilitation bank and CDBG loans. The loan servicing company remittance report is RRHA's only source document listing current loans and the name of each loan holder. The rehabilitation department maintains the homeowner loan files and a partial loan data base. A complete data base for two years of bank loans and a partial data base reportedly exists for CDBG loans. The loan files are organized by property address and do not correspond with remittance reports. Therefore, loan numbers, investor codes, homeowner names, etc... are useless in attempting to locate a specific loan. The RRHA currently relies on the memories of the rehabilitation department staff to identify and locate requested loan files when the address is unknown. The data base documents homeowner and property records, but is not used to track current loan balances or to identify delinquencies. Reports cannot be generated from the data base because the program is incomplete.

According to RRHA's financial advisor, the data base is incomplete



due to a lack of financial resources. The RRHA ran out of funding before the report portion of the program was completed. The rehabilitation department has discussed the situation with the Executive Director and finance department. The financial advisor explained the Executive Director would like to have the ability to

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access and review the rehabilitation loan portfolio. The finance department is making an effort to find and allocate additional resources to enable the completion of the rehabilitation loan database.

By not maintaining a rehabilitation loan database, the RRHA is placing reliance on the loan servicing company to identify and track all bank and CDBG loans. RRHA provides no assurance to the extent and accuracy of its loan portfolio.

#### **Requested journal entries not provided**

As of April 16, 1996, the RRHA did not locate seven of eighteen journal entries requested during our review. None of the seven entries requested, that were prepared prior to December 24, 1994, were provided.

According to the DDF, the journal vouchers are still missing and probably still in storage. The DDF suggested the journal vouchers may have been taken from the RRHA by a former employee.

Journal vouchers of a routine and non-routine nature were reviewed to verify the accuracy of accounting entries and to address a complaint issue, that CDBG funds were being used to pay off bank loans. The unavailability of these journal vouchers did not allow us to adequately address the issue and determine if CDBG funds were being used to pay off bank loans.

#### **Incorrect accounting entries**

A review of accounting journal vouchers disclosed undetected incorrect accounting entries made by the RRHA's accounting staff. For example, on a journal voucher dated April 12, 1995 the amounts posted to two advance accounts were booked incorrectly. The amount credited to the advance accounts were posted as a credit to interest income and vice versa. Having brought the error to the RRHA's attention they plan to correct the error.

This error causes the advance and interest income accounts to be overstated. The error also suggests the existence of additional general ledger posting errors undetected by the RRHA and reduces the reliance one can place on the accuracy of the general ledger.

The DDF stated the RRHA is aware that internal controls require improvement and explained that a formal internal control review would be performed by RRHA's internal auditors as a part of the upcoming financial statement audit. He also explained that due to recent changes in RRHA's organizational structure the implementation of additional controls should be easier.

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In summary, the RRHA must strengthen internal accounting controls over the CDBG rehabilitation loan program. By not maintaining adequate internal accounting controls, RRHA cannot ensure the accuracy of: rehabilitation loan balances, journal entries booked to the general ledger, and general ledger account balances. RRHA also cannot support its portfolio of CDBG rehabilitation loans and the legitimacy and accuracy of all journal entries.

#### **Auditee Comments**

RRHA stated they are currently using and reviewing the correct remittance reports to assist in bank reconciliations and will review each month in the current fiscal year to ensure receipts are properly recorded by July 31, 1996. The RRHA is committed to completing the loan data base by December 31, 1996. The RRHA believes the causes that generated the disclosed issues were personnel based and they have taken the appropriate corrective action.

#### **Recommendations**

We recommend your staff verify the RRHA has implemented the following:

- 2A. Request the loan servicing company to issue the same remittance reports as issued to the bank and utilize the remittance reports to properly reconcile the bank statement.
- 2B. Review remittance reports for variances in order to ensure the accuracy of journal entries and to assist in documenting and tracking loan account balances.
- 2C. Complete the partially established rehabilitation loan database and obtain and utilize exception reports to update and track homeowner, as well as, bank and CDBG loan groupings.
- 2D. Establish a system to ensure the security of current and

archived RRHA records and provide the missing journal vouchers requested during the review.

- 2E. Correct the accounting entries made April 12, 1995 and establish a supervisory oversight system to test accounting entries to assure they are correct and properly posted.

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